

§ 1.593-10

26 CFR Ch. I (4-1-09 Edition)

Revenue Code of 1939, or the corresponding provisions of prior revenue laws, if X had been subject to the income tax imposed by such Code or prior revenue laws when such interest was received. At the close of 1951, the sum of X's surplus, undivided profits, and reserves was \$650,000. At the close of 1954, X had pre-1963 reserves of \$10,000, and surplus, undivided profits, and reserves of \$630,000. At the close of 1955, X had pre-1963 reserves of \$15,000, and surplus, undivided profits, and reserves of \$625,000. At the close of 1962, X had pre-1963 reserves of \$55,000, nonqualifying loans of \$4 million, and qualifying real property loans of \$10 million. It is assumed that, under § 1.166-4, \$16,000 would constitute a reasonable addition to the reserve for losses on nonqualifying loans for a period in which such loans increased from zero to \$4 million and \$20,000 would constitute a reasonable addition to the reserve for losses on qualifying real property loans for a period in which such loans increased from zero to \$10 million.

(2) *Impairment of surplus, undivided profits, and reserves for 1954.* The sum of X's surplus, undivided profits, and reserves at the close of 1951 was impaired during 1954 by \$30,000, computed as follows:

Sum of surplus, undivided profits, and reserves at close of 1951	\$650,000
Less:	
Sum of surplus, undivided profits, and reserves at close of 1954, excluding pre-1963 reserves at close of such year (\$630,000 minus \$10,000)	620,000
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	30,000

(3) *Impairment of surplus, undivided profits, and reserves for 1955.* The sum of X's surplus, undivided profits, and reserves at the close of 1951 was further impaired during 1955 by \$10,000, computed as follows:

Sum of surplus, undivided profits, and reserves at close of 1951, decreased by amount of 1954 impairment (\$650,000 minus \$30,000) ...	\$620,000
Less:	
Sum of surplus, undivided profits, and reserves at close of 1955, excluding pre-1963 reserves at close of such year (\$625,000 minus \$15,000)	610,000
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	10,000

(4) *Pre-1952 surplus.* X's pre-1952 surplus is \$549,000, computed as follows:

Sum of surplus, undivided profits and reserves at close of 1951 ...	\$650,000
Less:	
Sum of impairments for 1954 and 1955 (\$30,000 plus \$10,000)	40,000
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	\$610,000

Less:

Portion of such \$610,000 which is attributable to excludable interest (\$610,000 multiplied by \$300,000/\$3 million)	61,000
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	549,000

(5) *Allocation of pre-1963 reserves to reserve for losses on nonqualifying loans and to reserve for losses on qualifying real property loans.* Of the \$55,000 of pre-1963 reserves at the close of 1962, \$16,000 (the amount which would constitute a reasonable addition to the reserve for losses on nonqualifying loans for a period in which such loans increased from zero to \$4 million) shall be allocated to, and constitute the opening balance of, the reserve for losses on nonqualifying loans, and the balance of \$39,000 (\$55,000 minus \$16,000) shall be allocated to, and constitute a part of the opening balance of, the reserve for losses on qualifying real property loans.

(6) *Allocation of pre-1952 surplus to reserve for losses on qualifying real property loans.* X's pre-1963 reserves are not sufficient to bring the opening balance of the reserve for losses on qualifying real property loans to \$300,000, which is an amount equal to the greater of:

- \$300,000 (i.e., \$10 million of qualifying real property loans outstanding at the close of 1962, multiplied by 3 percent), or
- \$20,000 (the amount which would constitute a reasonable addition to the reserve for losses on such loans under § 1.166-4 for a period in which the amount of such loans increased from zero to the \$10 million).

Therefore, \$261,000 (\$300,000 minus \$39,000) of X's pre-1952 surplus of \$549,000 shall be deemed to be included in the opening balance of such reserve in order to increase such opening balance to \$300,000.

[T.D. 6728, 29 FR 5861, May 5, 1964, as amended by T.D. 549, 43 FR 21457, May 18, 1978]

§ 1.593-10 Certain distributions to shareholders by a domestic building and loan association.

(a) *In general.* Section 593(f) provides that if a domestic building and loan association (as defined in section 7701(a)(19) and the regulations thereunder) distributes property after December 31, 1962, to a shareholder with respect to its stock and if the amount of such distribution is not allowable to the association as a deduction under section 591 (relating to deduction for dividends paid on deposits), then, notwithstanding any other provision of the Code, the distribution shall be treated as provided in paragraphs (b) and (c) of this section. For purposes of

the preceding sentence, the term *distribution* includes any distribution in redemption of stock to which section 302(a) or 303 applies, or in partial or complete liquidation of the association, as well as any other distribution which the association may make to a shareholder with respect to its stock. For definition of the term *property*, see section 317(a). For determination of the amount of a distribution, see section 301(b). For taxable years beginning after July 11, 1969, this paragraph is not applicable to any transaction to which section 381 (relating to carryovers in certain corporate acquisitions) and the regulations thereunder apply.

(b) *Distributions out of certain reserves*—(1) *Distributions not in exchange for stock*. If the distribution is not a redemption to which section 302(a) or 303 applies or in partial or complete liquidation of the association, then to the extent that the distribution is not out of earnings and profits of the taxable year (within the meaning of section 316(a)(2)) or out of earnings and profits accumulated in taxable years beginning after December 31, 1951, the distribution shall be treated as made out of:

(i) First, the reserve for losses on qualifying real property loans (determined under subparagraph (3) of this paragraph), to the extent thereof,

(ii) Second, the supplemental reserve for losses on loans, to the extent thereof, and

(iii) Finally, such other accounts as may be proper.

(2) *Distributions in redemption of stock or in liquidation*. If the distribution is a redemption to which section 302(a) or 303 applies, or in partial or complete liquidation of the association, the distribution shall be treated as made out of:

(i) First, the reserve for losses on qualifying real property loans (as determined under subparagraph (3) of this paragraph), to the extent thereof,

(ii) Second, the supplemental reserve for losses on loans, to the extent thereof,

(iii) Third, earnings and profits of the taxable year (within the meaning of section 316(a)(2)),

(iv) Fourth, earnings and profits accumulated in taxable years beginning after December 31, 1951, and

(v) Finally, such other accounts as may be proper.

(3) *Special rule*. For purposes of subparagraphs (1)(i) and (2)(i) of this paragraph, the reserve for losses on qualifying real property loans shall be an amount equal to:

(i) The balance of such reserve determined as of the close of the taxable year after all adjustments for such year have been made (including the addition for such year determined under § 1.593-6 or § 1.593-6A (whichever is applicable)), minus.

(ii) The sum of:

(a) The amount which would have constituted the opening balance of such reserve (at the close of December 31, 1962) if such opening balance had been determined under the experience method described in paragraph (b)(3)(ii)(b) of § 1.593-7 (relating to allocation of pre-1963 reserves to the opening balance of the reserve for losses on qualifying real property loans), and

(b) The total amount of the annual additions which would have been made to such reserve under section 166(c) for taxable years ending after December 31, 1962, if each such addition had been determined under the experience method described in paragraph (d) of § 1.593-6 or paragraph (d) of § 1.593-6A, whichever is applicable for the taxable year of such addition.

For purposes of subdivision (i) of this subparagraph, the balance of the reserve for losses on qualifying real property loans shall include the total amount of any pre-1963 reserves allocated thereto under paragraph (b)(3) of § 1.593-7, but shall not include any pre-1952 surplus which is deemed to be included therein under paragraph (a) of § 1.593-8 (relating to allocation of pre-1952 surplus to the opening balance of the reserve for losses on qualifying real property loans).

(c) *Amount charged against reserve and included in gross income*—(1) *In general*. If a distribution is treated under paragraph (b) (1) or (2) of this section as having been made out of the reserve for losses on qualifying real property loans or out of the supplemental reserve for losses on loans, such reserves shall be

charged with, and gross income for the taxable year shall be increased by, an amount equal to the lesser of:

- (i) The amount of such reserves, or
- (ii) The amount which, when reduced by the amount of income tax imposed by chapter 1 of the Code and attributable to the inclusion of such amount in gross income, is equal to the amount of such distribution.

(2) *Special rule.* For purposes of subparagraph (1)(ii) of this paragraph, in determining the income tax attributable to the inclusion of an amount in gross income, taxable income shall be determined without regard to any net operating loss carryback to the taxable year under section 172.

(d) *Examples.* This section may be illustrated by the following examples:

Example 1. (i) *Facts.* X Corporation, a domestic building and loan association having nonwithdrawable capital stock represented by shares, was organized in 1946, and makes its returns on the basis of the calendar year and the reserve method of accounting for bad debts. As of the close of December 31, 1962, X had \$6,900 of earnings and profits accumulated in taxable years beginning after December 31, 1951. X's taxable income for 1963 is \$30,000 (computed prior to the inclusion of any amount in gross income for such year under section 593(f)) and during such year X received tax-exempt interest of \$500. X's earnings and profits for 1963 (computed at the close of the taxable year without diminution by reason of any distributions made during the taxable year) is \$20,400. The opening balance of X's reserve for losses on qualifying real property loans as of the close of December 31, 1962 (determined under paragraph (b)(3)(ii)(a) of § 1.593-7) was \$24,500. Pre-1963 reserves of \$22,500 were included in such opening balance, but it is assumed that pre-1963 reserves of only \$2,500 would have been included in the opening balance if the opening balance had been determined under the experience method described in paragraph (b)(3)(ii)(b) of § 1.593-7. Pre-1952 surplus of \$2,000 was deemed included in such opening balance under paragraph (a) of § 1.593-8. The deductible addition to such reserve for 1963 is \$47,000. It is assumed that the addition to such reserve for 1963 would have been \$2,200 if such addition had been computed under the experience method described in paragraph (d) of § 1.593-6. On each of four dates during 1963 (January 1, April 1, July 1, and October 1), X made a \$12,000 distribution (which was not a redemption to which section 302(a) or 303 applied or in partial or complete liquidation of X) to its shareholders with respect to its stock.

- (ii) *Reserve for losses on qualifying real property loans.* For purposes of paragraph (b)(1)(i) of this section, X's reserve for losses on qualifying real property loans is \$64,800, computed as follows:

Closing balance of reserve for losses on qualifying real property loans after addition for 1963 (\$24,500 opening balance plus \$47,000 addition)	\$71,500
Minus:	
Amount of pre-1963 reserves which would have been included in opening balance under experience method	2,500
Total additions which would have been made under experience method	2,200
Pre-1952 surplus included in opening balance	2,000
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	6,700
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	64,800

- (iii) *Treatment of distributions.* Of each \$12,000 quarterly distribution, \$5,100 (\$20,400 earnings and profits of the taxable year divided by 4) is out of X's earnings and profits of the taxable year (within the meaning of section 316(a)(2)); the remainder of the January 1 distribution, \$6,900 (\$12,000 minus \$5,100), is out of X's earnings and profits accumulated in taxable years beginning after December 31, 1951. Since \$20,700 (\$6,900 multiplied by 3) is not out of X's earnings and profits, such amount shall be treated as made out of X's reserve for losses on qualifying real property loans (as determined under subdivision (ii) of this example).

- (iv) *Amount charged against reserve for losses on qualifying real property loans and included in gross income.* The reserve for losses on qualifying real property loans is charged with, and X's gross income for 1963 is increased by, \$43,124, which is the lesser of:

- (a) \$64,800 (the reserve as of December 31, 1963, as determined under subdivision (ii) of this example), or

- (b) \$43,124, i.e., the amount which, when reduced by the amount of income tax attributable to the inclusion of such amount in gross income, \$22,424 (\$43,124 multiplied by a tax rate of 52 percent), is equal to the amount of such distribution, \$20,700.

Example 2. (i) *Facts.* Assume the same facts as in example 1 and the following additional facts: X's taxable income for 1964 is \$6,000. The deductible addition to the reserve for losses on qualifying real property loans for 1964 is \$11,000, but it is assumed that only \$2,676 would have been the addition to such reserve for 1964 if such addition had been computed under the experience method described in paragraph (d) of § 1.593-6. On December 31, 1964, X makes a \$10,000 distribution in a redemption to which section 302(a) applies.

- (ii) *Reserve for losses on qualifying real property loans.* For purposes of paragraph (b)(2)(i)

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of this section, X's reserve for losses on qualifying real property loans is \$30,000, computed as follows:

Closing balance of reserve for losses on qualifying real property loans after addition for 1964 (\$71,500 opening balance plus \$11,000 addition)	\$82,500
Minus:	
Amount of pre-1963 reserves which would have been included in opening balance under the experience method	\$2,500
Total additions which would have been made under the experience method (\$2,200 for 1963 plus \$2,676 for 1964)	4,876
Pre-1952 surplus included in opening balance	2,000
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	9,376
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	73,124
Less charge against reserve under subdivision (iv) of example 1 for 1963 distribution	43,124
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	30,000

(iii) *Treatment of distribution.* The \$10,000 distribution in a redemption to which section 302(a) applies shall be treated as made out of X's reserve for losses on qualifying real property loans (as determined under subdivision (ii) of this example).

(iv) *Amount charged against reserve for losses on qualifying real property loans and included in gross income.* The reserve for losses on qualifying real property loans is charged with, and X's gross income for 1964 is increased by, \$12,820, which is the lesser of:

(a) \$30,000 (the reserve as of December 31, 1964, as determined under subdivision (ii) of this example), or

(b) \$12,820, i.e., the amount which, when reduced by the amount of income tax attributable to the inclusion of such amount in gross income, \$2,820 (\$12,820 multiplied by a tax rate of 22 percent), is equal to the amount of such distribution, \$10,000.

Example 3. (i) *Facts.* X Corporation, a domestic building and loan association having nonwithdrawable capital stock represented by shares, was organized in 1946, and makes its returns on the basis of the calendar year and the reserve method of accounting for bad debts. As of the close of December 31, 1962, X had \$6,900 of earnings and profits accumulated in taxable years beginning after December 31, 1951. X's taxable income for 1963 is \$30,000 (computed prior to the inclusion of any amount in gross income for such year under section 593(f)) and during such year X received tax-exempt interest of \$500. X's earnings and profits for 1963 (computed at the close of the taxable year without diminution by reason of any distributions made during the taxable year) is \$20,400. The opening balance of X's reserve for losses on qualifying real property loans as of the close of December 31, 1962 (determined under para-

graph (b)(3)(ii)(a) of § 1.593-7) was \$24,500. Pre-1963 reserves of \$24,500 were included in such opening balance, but it is assumed that pre-1963 reserves of only \$4,500 would have been included in the opening balance if the opening balance had been determined under the experience method described in paragraph (b)(3)(ii)(b) of § 1.593-7. The deductible addition to such reserve for 1963 is \$500. It is assumed that the addition to such reserve for 1963 would have been \$100 if such addition had been computed under the experience method described in paragraph (d) of § 1.593-6. As of December 31, 1963, the balance of X's supplemental reserve for losses on loans is \$30,000. On each of four dates during 1963 (January 1, April 1, July 1, and October 1), X made a \$12,000 distribution (which was not a redemption to which section 302(a) or 303 applied or in partial or complete liquidation of X) to its shareholders with respect to its stock.

(ii) *Reserve for losses on qualifying real property loans.* For purposes of paragraph (b)(1)(i) of this section, X's reserve for losses on qualifying real property loans is \$20,400, computed as follows:

Closing balance of reserve for losses on qualifying real property loans after addition for 1963 (\$24,500 opening balance plus \$500 addition)	\$25,000
Minus:	
Amount of pre-1963 reserves which would have been included in opening balance under experience method	\$4,500
Total additions which would have been made under experience method	100
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	4,600
	<hr/>
	20,400

(iii) *Treatment of distributions.* Of each \$12,000 quarterly distribution, \$5,100 (\$20,400 earnings and profits of the taxable year divided by 4) is out of X's earnings and profits of the taxable year (within the meaning of section 316(a)(2)); the remainder of the January 1 distribution, \$6,900 (\$12,000 minus \$5,100), is out of X's earnings and profits accumulated in taxable years beginning after December 31, 1951. Since \$20,700 (\$6,900 multiplied by 3) is not out of X's earnings and profits, \$20,400 of such amount shall be treated as made out of X's reserve for losses on qualifying real property loans (as determined under subdivision (ii) of this example) and \$300 (\$20,700 minus \$20,400) shall be treated as made out of X's supplemental reserve for losses on loans.

(iv) *Amount included in gross income.* X's gross income for 1963 is increased by \$43,124, which is the lesser of:

(a) \$50,400 (\$20,400, the reserve for losses on qualifying real property loans, as determined under subdivision (ii) of this example, plus \$30,000, the supplemental reserve for losses on loans), or

(b) \$43,124, *i.e.*, the amount which, when reduced by the amount of income tax attributable to the inclusion of such amount in gross income, \$22,424 (\$43,124 multiplied by a tax rate of 52 percent), is equal to the amount of such distribution, \$20,700.

(v) *Amount charged against reserve for losses on qualifying real property loans and supplemental reserve for losses on loans.* The reserve for losses on qualifying real property loans is charged with \$20,400 (the balance of the reserve as of December 31, 1963, as determined under subdivision (ii) of this example), and the supplemental reserve for losses on loans is charged with \$22,724 (\$43,124, the amount included in gross income under subdivision (iv) of this example, minus \$20,400).

[T.D. 6728, 29 FR 5862, May 5, 1964, as amended by T.D. 549, 43 FR 21457, May 18, 1978]

§ 1.593-11 Qualifying real property loan and nonqualifying loan defined.

(a) *Loan defined.* For purposes of this section, the term *loan* means debt, as the term *debt* is used in section 166 and the regulations thereunder. The term *loan* also includes a redeemable ground rent (as defined in section 1055 (c)) which is owned by the taxpayer, and any property acquired by the taxpayer in a transaction described in section 595(a). For determination of the amount of a loan, see paragraph (d) of this section.

(b) *Qualifying real property loan defined—(1) General rule.* For purposes of §§ 1.593-4 through 1.593-10, the term *qualifying real property loan* means any loan (other than a loan described in subparagraph (5) of this paragraph) which is secured by an interest in qualifying real property. For purposes of this section, the term *real property* means any property which, under the law of the jurisdiction in which such property is situated, constitutes real property. The term *real property* also includes a mobile unit which is permanently fixed to real property. The determination of whether a mobile unit is permanently fixed to real property shall be made on the basis of facts and circumstances in each particular case. For example, a mobile unit is permanently fixed to real property during a taxable year if, except for a brief period during which the unit is transported to a site, such unit was placed upon a foundation at a site with wheels and axles removed, affixed to the

ground by means of straps, and connected to water, sewer, gas, and electric facilities. See paragraph (e) of this section for the treatment of a REMIC interest as a qualifying real property loan.

(2) *Meaning of Secured.* A loan will be considered as *secured* only if the loan is on the security of any instrument (such as a mortgage, deed of trust, or land contract) which makes the interest of the debtor in the property described therein specific security for the payment of the loan, provided that such instrument is of such a nature that, in the event of default, the property could be subjected to the satisfaction of the loan with the same priority as a mortgage or deed of trust in the jurisdiction in which the property is situated.

(3) *Meaning of interest.* The word *interest* means an interest in real property which, under the law of the jurisdiction in which such property is situated, constitutes either (i) an interest in fee in such property, (or in the case of a mobile unit, an ownership interest), (ii) a leasehold interest in such property extending or renewable automatically for a period of at least 30 years, or at least 10 years beyond the date scheduled for the final payment on the loan secured by such interest, (iii) a leasehold interest in improved residential real property consisting of a structure or structures containing, in the aggregate, no more than four family units extending for a period of at least 2 years beyond the date scheduled for the final payment on the loan secured by such interest, or (iv) a leasehold interest in such property held subject to a redeemable ground rent defined in section 1055(c).

(4) *Meaning of qualifying real property.* The term *qualifying real property* means any real property which is improved real property, or which from the proceeds of the loan will become improved real property. As used in the preceding sentence, the term *improved real property* means:

(i) Land on which is located any building of a permanent nature (such as a house, mobile unit, apartment house, office building, hospital, shopping center, warehouse, garage, or other similar permanent structure),